GA1.13:GGD-82-53/rev.

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Bank Merger Process Should Be Modernized And Simplified

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Federal agencies do not have uniform criteria for evaluating proposed mergers and, as a result, make conflicting assessments of mergers.

Unlike nonbanking commerce, Federal banking laws do not provide for shell corporations to facilitate the takeover of total ownership of an entity. Bank holding companies or stockholders are using a complex merger process to obtain total ownership of a bank. This process, which could be simplified, is expensive, time consuming, and burdensome.

This report contains recommendations to the Congress and the three Federal banking agencies to modernize and simplify the laws and procedures used by the agencies to assess and approve bank merger applications.

GAO/GGD-82-53
AUGUST 16, 1982

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COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

BANK MERGER PROCESS SHOULD BE MODERNIZED AND SIMPLIFIED

D I G E S T

As the number of bank mergers grows and the uses for the merger process change, shortcomings have surfaced both in the law governing the process as well as in the process itself. While GAO takes no position on whether mergers are "good or bad" for the banking inindustry, it believes that the merger laws could be updated to relieve needless administrative burdens placed on merger applicants and the Federal bank regulatory agencies who must process merger applications.

GAO undertook this review because of recent increases in the number of bank mergers and the potential for further increases. These increases could result from changes in State banking laws to remove limitations on branching or changes in Federal laws to permit banks and bank holding companies to acquire other types of financial institutions or to acquire banks or branches outside of their home States. Also, increases could be precipitated by a significant deterioration in the financial condition of banks. (See pp. 5 to 7.)

UNIFORM STANDARDS NEEDED FOR EVALUATING MERGERS

Broadly speaking, in acting on merger applications, the Federal and State agencies consider (1) the financial condition of the applicant banks; (2) the character and experience of the management of the surviving bank; (3) whether the convenience and needs of the community will be served; and (4) the effects of the merger on competition.

Although Federal bank regulators' assessments of the competitive effects of proposed mergers received the most consideration and involved the most controversy, the agencies' evaluations were not uniform, and specific criteria had not been developed for making the evaluations. The regulators defined the relevant market to be used in evaluating competitive effects of proposed mergers in different ways

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and lacked uniform criteria in applying the line of commerce and potential competition concepts. (See p. 13.)

This has resulted in conflicting decisions by Federal regulators and encourages "agency shopping" whereby parties to a merger seek out the Federal bank regulator possessing the most lenient standards for assessing mergers. (See p. 15.)

A 1963 Supreme Court decision establishing commercial banking as a single line of commerce caused Federal bank regulators to generally consider only banks when making competitive analyses of mergers. The distinction between banks and other competing institutions has eroded significantly since 1963. GAO believes that the Congress should specifically provide that the Federal bank regulators, to the extent practicable, consider competing nonbank financial institutions in assessing the competitive effects of mergers. (See pp. 22 and 23.)

The effect that a merger is likely to have upon the future concentration of banking resources in the relevant market has long been a subject of controversy. The potential competition doctrine asserts that the merging of two banks not now in competition with each other may nevertheless have an anticompetitive effect because the merger eliminates the probability that the two banking organizations might become competitors in the future. This doctrine by its very nature is ambiguous and difficult to apply. As a result, Federal bank regulators do not consider this issue uniformly in assessing mergers. (See p. 17.)

THE PHANTOM BANK MERGER PROCESS COULD BE ELIMINATED

Despite its frequent use, the phantom bank merger process is expensive, time consuming, and burdensome to banks, bank holding companies, and Federal regulators. This process involves the chartering of a phantom bank for the sole purpose of facilitating the conversion of a target bank into a wholly owned subsidiary of a bank holding company. Generally,

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it never emerges as an operating bank and the resulting bank in the merger transaction is, in most cases, indistinguishable in name, location, and services offered from the target bank.

A typical use of the phantom bank merger process would be as follows. The stockholders who control at least two-thirds of the voting stock of a bank want to gain total control of the bank. These stockholders request approval from the Federal Reserve Board to establish a bank holding company. The bank holding company then obtains a charter for a phantom bank from either the Office of the Comptroller of the Currency or a State regulatory agency. The newly chartered bank is referred to as a phantom bank because it never exists as an operating entity. The existing bank is merged with the phantom bank which is wholly owned by the bank holding company. Shareholders of the targeted bank receive bank holding company stock for their shares at a specified ratio; however, shareholders who oppose the merger may receive cash for their shares in lieu of holding company stock. The bank holding company thus will own 100 percent of the surviving bank's stock.

GAO was advised that the complicated phantom bank merger process is used because banking laws do not provide for shell corporations which serve similar purposes for nonbank corporations. (See p. 32.)

GAO is proposing to eliminate the requirement to charter a phantom bank and merge it with the bank targeted for acquisition. Instead, GAO recommends that the bank holding company submit a plan to the Federal Reserve Board outlining its acquisition intents and methods. This plan would be filed in conjunction with the bank holding company application. (See p. 37.)

GAO believes that this proposal would reduce costs and expedite the acquisition process while having no adverse effect on the parties to the transaction or the public. The GAO change could reduce costs to national banks by an estimated $8,000 to $54,000 for each merger. The estimated savings for State-chartered banks would be somewhat less with estimates ranging from $500 to $8,400 per

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merger. In addition, Federal regulators could reduce their costs associated with reviewing and processing these applications. (See pp. 40 to 42.)

THE MERGER PROCESS SHOULD BE STREAMLINED

It currently takes months to process a merger application--a delay which can cause some problems for applicants. While the bank regulators have made some efforts to streamline the application process, GAO recommends additional changes to agency practices and merger law which would reduce administrative costs and, more importantly, reduce processing times for merger applications. For example, the publication and comment periods for merger applications are spread out for longer periods than for other types of organization changes and should be shortened. (See p. 45.)

RECOMMENDATIONS TO THE CONGRESS

The Congress should amend the Bank Merger Act and the Bank Holding Company Act to

--provide that, to the extent practicable, the Federal bank regulatory agencies consider competing nonbank financial institutions in evaluating the competitive effects of a bank merger (see p. 31);

--provide an alternative to the phantom merger process (see p. 43);

--exempt phantom mergers and corporate reorganizations from competitive effects assessments (see p. 61);

--exempt phantom mergers and corporate reorganizations from the Attorney General review (see p. 61); and

--delete the publication and comment period for certain mergers and shorten the period for others (see p. 61).

Suggested draft language to implement these recommendations is included in appendix II of this report.

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RECOMMENDATIONS TO BANKING AGENCIES

GAO made several recommendations to the banking agencies which provide for evaluating the competitive effects of a merger, the timely furnishing of competitive reports, improving coordination with State bank regulators, and delegating more approval authority to their field offices. (See pp. 31 and 61.)

AGENCY COMMENTS AND GAO'S EVALUATION

The Department of Justice, the Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation generally agreed with the problems identified by GAO. The principal disagreement expressed by the agencies concerned GAO's recommendation that the Congress amend the law to provide that the Federal agencies consider competing nonbank financial institutions when evaluating the competitive effects of a bank merger.

Basically, the agencies interpreted our recommendation as requiring the Congress to specify a list of competing institutions that the agencies should consider when evaluating proposed mergers. The agencies were concerned that any statutory list would soon become outdated and that the agencies should have flexibility to make decisions on which competitors to include without added statutory restrictions. This was not the intent of the GAO recommendation, and the language in the final report has been revised to clearly provide the agencies with needed flexibility in this area.

Specific agency comments and GAO's evaluation are included on pages 27 to 30, 44, and 62. The full texts of all comments received appear in appendixes III through VII.

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ABBREVIATIONS

ATS	automatic transfer service
BHC	bank holding company
FDIC	Federal Deposit Insurance Corporation
FRS	Federal Reserve System
GAO	General Accounting Office
IPC	individual, partnership, and corporate
NOW	negotiable order of withdrawal
OCC	Office of the Comptroller of the Currency
RMA	Ranally Metropolitan Area
S&L	savings and loan association
SEC	Securities and Exchange Commission